March 4, 2022

VIA ELECTRONIC SUBMISSION: rule-comments@sec.gov

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: File No. S7-07-15, Reopening of Comment Period for Pay Versus Performance

Dear Ms. Countryman,

Nareit appreciates the opportunity to submit these comments responding to the reopening by the Securities and Exchange Commission (SEC) of the comment period for the SEC’s proposed Pay Versus Performance disclosure rules (the Proposal). Nareit and its members have long understood the importance of providing accurate and meaningful disclosure regarding executive compensation design and assessment to real estate investment trust (REIT) investors.

Nareit serves as the worldwide representative voice for REITs¹ and real estate companies with an interest in U.S. income-producing real estate. Nareit’s members are REITs and other real estate companies throughout the world that own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service those businesses.

Overview

Nareit strongly favors a “principles-based” approach to SEC disclosure and believes this approach is best suited to address the need for consistent and relevant information to stakeholders in the constantly evolving business environment in which REITs and other businesses operate. Consistent with this approach, Nareit commends the SEC for contemplating in the Proposal that registrants may select their own measures of performance and for focusing on the risk that overly prescriptive requirements may lead to registrants

¹ Through the diverse array of properties they own, finance, and operate, REITs help provide the essential real estate that revitalize neighborhoods, enable the digital economy, power community essential services, and build the infrastructure of tomorrow, while creating American jobs and economic activity along the way. REITs of all types collectively own more than $3.5 trillion in gross assets across the U.S., with stock-exchange listed REITs owning over $2.5 trillion in assets. U.S. listed REITs have an equity market capitalization of more than $1.6 trillion. REITs provide everyday Americans the opportunity to invest in real estate, and 145 million Americans live in households that benefit from ownership of REITs through stocks, 401(k) plans, pension plans, and other investment funds.
misrepresenting or providing an incomplete picture of how pay relates to performance given the differences across companies in terms of performance measures that companies or investors care about.

The focus of this letter is on the aspects of the Proposal that contemplate requiring disclosure in tabular form of the following three additional measures of performance, which might provide additional clarity to investors as to the relation between executive compensation and financial performance: pre-tax net income, net income, and a measure specific to a particular registrant, chosen by said registrant (Company-Selected Measure).

As discussed further below,

- Due to certain features of the way REITs are organized and operated under federal tax law as well as certain features of U.S. GAAP, pre-tax net income and net income generally are not considered by REIT investors or REIT management when evaluating the alignment of pay with performance or used by REITs to link compensation actually paid during the fiscal year to company performance;

- We do not believe the SEC should require mandatory disclosure of pre-tax net income and net income in the context of any new Pay Versus Performance disclosure rules that are adopted;

- Nareit Funds from Operations (FFO) has been recognized by the SEC staff since 2002 as a standard non-GAAP performance measure for the real estate industry and this measure or variations of it are widely used by REITs as a performance measure in designing executive compensation plans, and we respectfully request that SEC acknowledge FFO, and FFO as adjusted, as an acceptable measure for disclosure in the context of any new Pay Versus Performance disclosure rules that are adopted; and,

- We support the SEC’s suggestion that registrants be permitted to report a “Company-Selected Measure,” because REITs may measure performance against such measures as Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) and Net Operating Income (NOI) in addition to or instead of FFO.

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3 EBITDA is a non-GAAP measure that has gained wide acceptance defined as earnings before interest, taxes, depreciation, and amortization.

4 NOI is a non-GAAP measure that has gained wide acceptance by REITs and investors. While NOI may be calculated differently by different REITs, NOI generally represents net income adjusted to reflect only those income and expense items that are incurred at the property operating level.
The Limited Utility and Relevance of Pre-Tax Net Income and Net Income for Measuring REIT Performance

Although REITs have much in common with other reporting companies, they also exhibit important differences that are critical to understanding REIT performance and its link to executive compensation, and certain of these differences lead to the conclusion that a REIT’s pre-tax net income and net income generally are not considered by investors when evaluating the alignment of pay with performance. Moreover, as discussed in more detail below, pre-tax net income and net income are generally not used by REITs to link compensation actually paid during the fiscal year to company performance.

REITs were established by Congress in 1960 to provide individual investors access to investments in income-producing real estate and mortgages otherwise only available to wealthy investors through partnerships. To effectuate this goal, Congress created a legal framework intended to promote longer term real estate investment and ensure that REIT income is distributed annually to shareholders. This operating framework is delineated within the Section 856 of the Internal Revenue Code (the Code) by numerous rules, restrictions and limitations under which REITs are required to operate, many of which are designed to ensure that REITs confine their activities to the business of real estate as a landlord or lender. Of relevance to the Proposal, among other requirements to qualify as a REIT, a company must distribute 90% of its taxable income each year and satisfy rigorous asset and income tests that effectively require that REITs primarily invest in qualifying real estate assets and primarily derive their income from such assets.

Accordingly, due to this operating framework, the vast majority of assets owned by REITs are real estate assets. The value of real estate assets historically changes in response to market conditions, including inflation, interest rates, unemployment and consumer spending. Historical cost accounting for real estate assets under U.S. Generally Accepted Accounting Principles (GAAP) implicitly assumes that the value of real estate assets diminishes predictably over time, although this has not been accurate over the long periods of time in which real estate investments have historically been valued. For this reason, to many investors and analysts, comparisons of the operating results of REITs that rely solely on net income have been less than satisfactory. To address this anomaly, in 1991 Nareit, working with its corporate members and the REIT investment community, developed a non-GAAP supplemental measure of REIT performance, Nareit FFO, described in more detail below, which is calculated by adding depreciation and amortization related to real estate to GAAP net income and subtracting gains and losses from real estate sales.

Also pursuant to the operating framework for REITs set forth in the Code, the concept of “pre-tax net income” is of limited value when assessing a REIT’s financial performance. REITs typically do not pay significant corporate income taxes at the federal level because they only pay tax on taxable income that has not been passed along as dividend payments to shareholders, which is usually all of their taxable income (except for

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5 The 1960 law establishing REITs (Internal Revenue Code sections 856, 857 and 858) was enacted as an amendment to the Cigar Excise Tax Extension, section 10(a) of Public Law no. 86-779, 74 Stat. 998, 1003-1008 (Sept. 14, 1960).
income generated by special taxable REIT subsidiaries). The pre-tax net income of a REIT is therefore generally not materially distinct from (or particularly meaningful when compared to) the net income of a REIT, which itself continues to be subject to the limitations discussed above as a measure of REIT performance.

**Disclosure of Pre-Tax Net Income and Net Income Should Be Permitted, Not Mandatory**

Nareit believes that a “one size fits all” benchmark is not appropriate for all companies, and we are writing this letter primarily to suggest that, instead of including pre-tax net income and net income as measures that registrants are required to disclose⁶, pre-tax net income and net income should be examples of additional measures registrants may elect to disclose if they believed such disclosure would be beneficial for investors.

Requiring REITs to disclose pre-tax net income and net income in the context contemplated by the Proposal would complicate the task of understanding executive pay policies by emphasizing information that is not particularly relevant or material to measuring the performance of REITs, while obscuring the elements of the proposed disclosure that would be most helpful to investors interested in better understanding how a REIT’s compensation paid over time relates to its performance over time.

Disclosing pre-tax net income and net income in the context contemplated by the Proposal could also lead REITs to be required to provide significant additional accompanying disclosure explaining how and why net income and pre-tax net income are not relevant or helpful to measuring performance. We do not believe this is beneficial to investors and could cause some to be confused or misled.

**FFO Should Be Recognized as an Acceptable Performance Measure**

For some of the same reasons that REITs and REIT investors do not focus on pre-tax net income and net income discussed above, most REITs also report the non-GAAP measure FFO in accordance with standards published by Nareit⁷ and on an adjusted basis, in each case subject to compliance with SEC rules and guidance applicable to reporting non-GAAP measures. FFO has been recognized by the SEC staff since 2002 as a standard non-GAAP performance measure for the real estate industry.⁸ FFO has also gained wide acceptance by REITs and investors.

Nareit believes—and investors have confirmed— that FFO prepared in accordance with Nareit’s definition, presented in conjunction with and reconciled with the financial statements prepared in accordance with GAAP,

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⁶ Specifically, the Proposal contemplates requiring disclosure in tabular form of the following three additional measures of performance, which would provide additional clarity to investors as to the relation between executive compensation and financial performance: pre-tax net income, net income, and a measure specific to a particular registrant, chosen by said registrant (Company-Selected Measure).


⁸ See supra note 2.
has been fundamentally beneficial, improving the understanding of operating results of REITs as real estate companies among the investing public and enhancing the ability to compare the operating results of one REIT with another. Moreover, based on the 2021 Nareit Compensation Survey⁹, a significant percentage of REITs use FFO or an adjusted version of FFO reconciled to Nareit-defined FFO as a measure of performance in both annual and long-term incentive compensation programs.

We therefore respectfully request that SEC acknowledge FFO and FFO as adjusted as acceptable measures for disclosure in the context of any new Pay Versus Performance disclosure rules that are adopted.

**REITs Should Be Permitted to Report other Widely-used Performance Measures**

Nareit supports the SEC’s suggestion that registrants be permitted to report a “Company-Selected Measure.” Our annual compensation survey also reports that other non-GAAP measures are commonly reported by REITs, such as EBITDA¹⁰ and NOI¹¹. Notably, the survey and other Nareit survey data going back years do not note any instance of a REIT using pre-tax net income or net income as a performance measure.¹²

**Conclusion**

Nareit and its members appreciate the opportunity to share the perspective of the REIT and publicly traded real estate community on these important matters. We would be happy to answer any questions about our comments and to serve as a resource to the SEC and its staff as it moves forward with its efforts to require additional disclosures regarding pay versus performance.

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⁹ As a service to its members, Nareit sponsors an annual compensation survey. The 2021 survey was conducted by Ferguson Partners and is designed to provide real estate companies, including REITs, with competitive compensation levels and current information regarding the design, features, and administration of compensation programs. The 2021 survey had a participation rate of 51% of all Nareit corporate members. This rate represents approximately 60% of the equity market capitalization of all listed Nareit corporate members.

¹⁰ See supra note 3.

¹¹ NOI is another non-GAAP measure that has gained wide acceptance by REITs and investors. While NOI may be calculated differently by different REITs, NOI generally represents net income adjusted to reflect only those income and expense items that are incurred at the property operating level.

¹² To the extent that a registrant chooses to disclose FFO, EBITDA, NOI or any other non-GAAP measure as a Company-Selected Measure, then those non-GAAP financial measures are subject to the requirements of Regulation G and Item 10(e) of Regulation S-K. See SEC, Regulation S-K: Questions and Answers of General Applicability, Question 118.08 (July 8, 2011) (CDI 118.08), available at https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm (CDI 118.08). Accordingly, because, for FFO, EBITDA and NOI, net income is the most comparable measure calculated in accordance with GAAP, if FFO, EBITDA and NOI were chosen by a registrant as a Company-Selected Measure, a reconciliation of net income to FFO, EBITDA and NOI would then need to be included in the proxy statement or other applicable disclosure document. We would appreciate if the SEC could confirm that the principles of CDI 118.08 would apply in these circumstances, such that the SEC staff will not object if a registrant includes the required GAAP reconciliation and other information in an annex to the proxy statement, provided the registrant includes a prominent cross-reference to such annex. Or, if the non-GAAP financial measures are the same as those included in the Form 10-K that is incorporated by reference the proxy statement’s Item 402 disclosure as part of its Part III information, that the SEC staff will not object if the registrant complies with Regulation G and Item 10(e) by providing a prominent cross-reference to the pages in the Form 10-K containing the required GAAP reconciliation and other information.
Please do not hesitate to contact [Redacted] or [Redacted], Nareit Senior Vice President and Deputy General Counsel if you would like to discuss these comments, or related issues raised by the Proposal, in greater detail.

Respectfully submitted,

[Signature]

Steven A. Wechsler
President & CEO
Nareit